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MAR 26 1935

Honorable Thomas F. Ford,
House of Representatives,
Washington, D. C.

My dear Mr. Ford:

I regret that pressure of business has prevented an earlier reply to your letter of March 11, 1935, requesting my comments on the inclosed letter addressed to you by Mr. Edward Elliott, Vice President of the Security-First National Bank of Los Angeles, wherein Mr. Elliott expressed certain views about the proposed banking Act of 1935.

Regardless of the interpretation which Mr. Elliott may place upon my address before the Ohio Bankers Association and particularly the portion thereof with regard to the centralization of banking authority, the fact is that, if this Bill is enacted, the control of the Federal Reserve System will be no more political than it has been in the past. Under the present law, all of the appointive members of the Federal Reserve Board are appointed by the President for twelve-year terms and confirmed by the Senate and one of the appointive members is designated as Governor at the pleasure of the President. The Bill would make no change in this respect except to provide that, if the Governor be no longer designated as such by the President, he shall cease to be a member of the Board and shall be deemed to have served the full term for which he was appointed. The

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purpose of this is two-fold: (1) To create a vacancy in order that the President may be able to appoint to membership on the Board the person whom he desires to designate as Governor; and (2) to enable the outgoing Governor to reenter the banking business immediately, instead of having to wait two years as now required of a member of the Board who resigns before serving out his full term. Except for the second point, it is believed that the bill as introduced would make no change in the existing practical situation; because any member of the Board who had been designated as Governor and whose designation as such is terminated by the President will almost certainly resign as a member of the Board.

However, it would seem desirable to provide specifically for a vacancy in the membership of the Board in such circumstances, in order that there may be no doubt the President will be able to appoint to membership on the Board the person whom he desires to designate as Governor. The Board was created by Congress as an arm of the Federal Government to exercise governmental powers of vast importance; and it would seem appropriate for the Governor of the Board to be a person acceptable to the administration in power, in order that he might maintain a satisfactory liaison between the President and the Board. This would not mean that the Board as a whole would be dominated by the administration in power; because, even if the Governor, the Secretary of the Treasury and the Comptroller of the Currency be considered representatives of the administration, they would constitute only a

minority of the Board and the other five members usually would be persons appointed during preceding administrations. The twelve-year term of office of the appointive members constitutes a substantial safeguard against political domination over a majority of the Board members.

The provision making the appointment of the Governor of a Federal reserve bank subject to approval by the Federal Reserve Board would not subject the Federal Reserve System to political control; because the actions of the Federal Reserve Board are not influenced by political motives and because the Governor of the Federal reserve bank would have to be selected in the first instance by the Board of Directors of the bank, two thirds of whom are elected by the member banks.

Moreover, if this Bill is enacted, the Federal Reserve Board would actually have less control over the management of the Federal reserve banks than was contemplated by the original Federal Reserve Act. Under the original Act, it was contemplated that the Federal Reserve Agent would be the chief executive officer of the bank and he is designated by the Federal Reserve Board from among the Class C directors appointed by the Federal Reserve Board and is Chairman of the Board of Directors and the official representative of the Federal Reserve Board at the Federal reserve bank. He is appointed by the Federal Reserve Board alone; and the Board of directors of the bank have no voice whatever in his selection. The office

of Governor of the Federal reserve bank was created by the directors of the Federal reserve banks without any specific sanction of law and has never been recognized by Congress in any part of the Federal Reserve Act. The Bill would abolish the office of Federal Reserve Agent, combine the office of Chairman with that of Governor, and require the person filling the combined office to be satisfactory both to the directors of the bank and to the Federal Reserve Board. The Federal Reserve Board would no longer appoint a person of its own selection as Chairman of the Board of Directors but would merely approve of the person selected by the directors as Governor of the bank, who would thereupon become Chairman of the Board of Directors. The Bill would improve the organization of the Federal reserve banks by doing away with the dual heads of the banks and substituting a single chief executive officer who would be selected in the first instance by the Boards of Directors of the banks, but would have to be satisfactory to the Federal Reserve Board. This would result in smoother operation within the banks and smoother cooperation between the banks and the Federal Reserve Board.

Although Title I of the Bill provides for the insurance of trust funds up to $5,000, Mr. Elliott objects to the provision requiring the bank to pay an insurance fee on such funds when they are deposited in the commercial department of the bank and secured by a pledge of Government bonds with the trust department. This is a point which could be discussed more appropriately by the officials of the

Federal Deposit Insurance Corporation; but I cannot refrain from observing that I can see no logical reason why banks should not pay an insurance fee on trust funds if they are insured to the same extent as deposits, regardless of the fact that they may be secured by Government bonds. Moreover, I understand that the insurance fee of one twelfth of one per cent per annum has been worked out very carefully and the insurance fund might become inadequate if special classes of deposits are exempted from the assessments. Thus, deposits of funds of the Federal Government are secured by the pledge of Government obligations and to exempt such deposits would greatly reduce the basis of assessments and would make it necessary to increase the rate.

In my testimony before the Committee, I recognized that many State member banks have not heretofore been limited in the aggregate amount of real estate loans which they are authorized to make and that, if the Bill is enacted in its present form, many of them which already have made loans exceeding 60 per cent of their savings deposits will have to cease making real estate loans and will have to liquidate some of those already made when they reach maturity in order to bring themselves within the 60 per cent limitation. I recognized that this is objectionable and, in order to meet the situation, I suggested a substitute section which would omit the rigid statutory limitations and vest in the Federal Reserve Board the power to prescribe the necessary limitations by regulations which

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could be modified from time to time to meet changing conditions. If my proposed substitute section is adopted, the Federal Reserve Board can prescribe regulations which will meet the point raised by Mr. Elliott with respect to the 60 per cent limit on the aggregate amount of real estate loans that may be made by State member banks.

It would appear from Mr. Elliott's comments regarding the provisions governing the payment of interest on deposits that he is not familiar with the existing law on this subject. The exemption of deposits of mutual savings banks from the prohibition against the payment of interest on demand deposits is in the existing law, and the Bill would make no change in this respect. Likewise, the exemption of deposits of public funds made by or on behalf of any State, county, school district, or other subdivision of municipality with respect to which payment of interest is required by State law is also in the existing law and the only changes which would be made in this respect are to exempt also deposits of trust funds with respect to which the payment of interest is required by State law and deposits of public funds of the United States or any territory, district or possession, public instrumentality or agency thereof with respect to which interest is required by law to be paid. It may seem illogical to exempt such deposits from the prohibition against paying interest on demand deposits; but it is necessary, as a practical matter, where the law requires the payment of interest on such deposits. Otherwise member banks of the Federal Reserve System would be unable to accept such

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deposits and all of such funds would have to be deposited in nonmember banks.

Mr. Elliott's final comment is with respect to the provision requiring executive officers of member banks who borrow from other banking institutions to report the facts to the Boards of Directors of their own banks. In view of the discussion of this subject during my testimony before the Banking and Currency Committee on Friday, March 15, I believe that the Committee fully recognizes the propriety of this provision and is in sympathy with its purpose. However, I invite attention to the fact that the present law requires executive officers of member banks to report their borrowings from other banks to the Chairmen of the Boards of Directors of their own banks and the only change proposed in this respect is to require the reports to be made to the Boards of Directors instead of the Chairmen. This change was suggested by the Comptroller of the Currency for the practical reason that many national banks have no persons with the formal title of Chairman of the Board of Directors, and the Comptroller has received many inquiries as to how the existing law is to be complied with in such circumstances. I personally feel that it is very important for the Boards of Directors of member banks to know to what extent executive officers of the banks are indebted to other banking institutions, as indebtedness of this character may prevent an executive officer from being as impartial and as careful as he should be in passing upon extensions of credit by his own bank to the banks to which he is indebted.

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I appreciate very much this opportunity to comment upon the points raised by Mr. Elliott and I sincerely hope that the above comments clear up these points to your satisfaction. If they do not, I shall be very glad to have you communicate with me further on the subject.

In accordance with your request, I am returning Mr. Elliott's letter herewith; and I am also inclosing an extra copy of this letter.

With kind regards, I am

Cordially yours,

(Signed) Marriner S. Eccles

Inclosures

Marriner S. Eccles,
Governor.

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GENERAL COUNSEL'S OFFICE.
Dictated by.....
Approved by.....
Revised by.....

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